

A STUDY OF PRICE POLICY FOR SUCCESSFUL
NATIONAL PLANNING IN INDIA

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INTRODUCTION

India is an under-developed country with a dense population, overwhelmingly dependent on agriculture. The economy is characterized by low or static standards of living, chronic under-employment and widespread unemployment. The national income for a population of about 400 million and an area of about 1260 million square miles is only about 22 billion dollars as compared to \$415 billion for the USA. The per capita income in India is 56 dollars as compared to \$114 in Ceylon, \$196 in Japan, \$852 in the United Kingdom and \$1850 in the USA. Besides the low level of per capita income, India faces a problem in the nature of the income distribution. A wide gap exists between the average and the highest incomes.

India is, however, a country which won her Independence only about a decade ago. Immediately after the attainment of political independence, the attention of the government and the people has been focused on what the Prime Minister described as the "winning of economic independence." Political independence is only a means to an end. The real end is to promote the welfare of the people by eliminating "poverty, ignorance, and disease" and by opening out equal opportunities to all for a richer and more varied way of life.

In order to achieve these basic ideals, the need was felt for formulating a series of economic plans. National planning was deemed necessary because it was believed that relying solely on private enterprise was not likely to achieve development on a

scale and at the rate that was needed in India. Besides, there were so many unknown risks and uncharted areas to cover that private risk-bearers were not expected to plan their operations in a manner that would be consistent with the basic development of the country. Therefore, unanimous opinion was that the State should take up the responsibility, with the co-operation of private enterprise, for formulating and implementing national plans which would ensure the economic development of the whole country.

The First Five Year Plan was drawn up in 1950-51 against the background of shortages of food and raw materials and persisting inflationary pressure. Priority was accorded to development programs aimed at stepping up agricultural production and at the same time suitable measures were taken for arresting the rising spiral of prices. But while programs were drawn up to attend to immediate needs, the long term problems of the country were fully kept in view and the ground was being prepared for initiating a process of all-round and balanced economic development.

The economy responded well to the stimulus of the first plan. Both agricultural and industrial production showed substantial increases. The upward march of prices was halted. The main targets of production set out in the First Plan were realized and in some cases, particularly in the case of agricultural commodities, were even exceeded. Quite a number of new industrial plants both in the public and private sectors went into production. The national income during the five year period (1951-1956) rose by about 18 percent as against the original expectation of about 11 percent.

The Plan evoked a great deal of co-operation and participation on the part of the people. A wave of enthusiasm swept the populace and among them there was a longing for a new order of things and a determination to work for it. In short, the Plan generated a dynamic element in what was long considered to be a static and almost a stagnant situation.

The Second Five Year Plan was intended to carry forward the process of economic development that was initiated and achieved in the First and to prepare the way for more accelerated development in the succeeding plan periods. The principal objectives of the Second Five Year Plan are to secure a sizeable increase in national income and to work for a redistribution of the national income in a more equitable manner. In the process, the Plan will seek to expand employment opportunities and raise the level of living in the country. All this involves a substantial increase in investment and production. Emphasis will, therefore, be laid on the exploitation and development of minerals and the promotion of basic industries. As has already been stated, the Indian economy at present depends excessively on agriculture; it needs to be diversified and there is an urgent need for a big advance towards industrialization, particularly for the development of industries such as steel, machine tools, coal and heavy chemicals, if a more rapid rate of development is to be sustained in the future. This does not, however, mean that agriculture which was given priority in the First Plan will not receive the attention it deserves in the second or subsequent plans. The population of

India is increasing at the rate of about 5 millions a year and there is a serious drainage of foreign exchange owing to the mounting imports of food grains and other agricultural commodities. Therefore, while the emphasis on industrialization will remain and even increase with each succeeding Plan, for many years to come, the raising of agricultural yields will be an important objective of development. As long as agriculture continues to be the base of the economy of India, it will be the progress in the agricultural sector which will determine the pace of development in the industrial sector.

The success of any plan and the realization of its objectives depends on the quantity of resources that can be mobilized and the efficiency with which these resources can be directed towards priority uses. In the case of India's Second Five Year Plan, the need is urgent for increased flow of resources for investment on development programs. However, resources are scarce relative to ends and the problem is the same as in any economy, namely, how best to allocate the limited resources between alternative ends. It is here that the pricing system comes into play because "Price is the common denominator of different ends"¹ and it is through prices that it is possible to record the pulls of the different ends which compete for services of the available resources. The importance of the price mechanism in directing resources towards priority uses is thus obvious. In the following chapter the role of prices in the economy will be discussed in some detail.

¹Brown, H. Phelps, The Framework of the Pricing System, p. 170.

THE ROLE OF PRICE IN THE ECONOMY

Human Wants and Economic Resources

Economics is concerned with man's well being. The goal of economic security is the satisfaction of human wants. These wants are cultural as well as biological. They arise from the desire for such things as food and clothing, the satisfaction of which is indispensable for subsistence. They also arise from the culture within which we live and the desire bred by that culture for certain good things of life other than the very basic necessities. They may arise from other sources also; sometimes a new want is created in the very process of satisfying an old one. In the aggregate there is no limit to human wants and it is not possible for any economy to satisfy all the wants of all the people at any one time.

The means available for satisfying human wants are economic goods, the supply of which is dependent on the availability of resources and the degree of efficiency with which these resources are utilized. Resources come under two broad categories, (1) labor and, (2) capital. The former covers human effort being used in producing goods while the latter includes non-human resources such as buildings, machinery, land, etc., which contribute towards placing goods in the hands of the ultimate consumer. Resources have three general characteristics; firstly, most resources are limited in quantity in the sense that they are scarce, relative to the desire for the products which they can produce; secondly,

they are versatile, i.e., they can be put to different uses, "they are quite fluid with respect to the forms they can take and the kinds of goods they can produce;" and, thirdly, they can be combined in varying proportions. Very few goods require rigid proportions of resources. It is almost always possible to substitute some kinds of labor for capital and vice versa. This last characteristic of resources, together with the characteristic of versatility makes it possible for the economy to switch its productive capacity from one line of production to another. It is possible to transfer resources from industries engaged in producing goods which consumers want least into industries producing goods which consumers want most.

Thus, on one hand, we find that human wants are unlimited; on the other hand, economic resources which are capable of satisfying these wants are limited or scarce. Because the given means are insufficient to realize all of the given ends, and because the means can be applied alternatively to achieve different ends, there arises a problem of choice--a choice as to which wants are to be satisfied and in what degree. Every economic system, regardless of its type, is confronted with this fundamental economic problem and in that has to perform five closely related functions. It has to determine:

- (a) What commodities shall be produced and in what quantities.
- (b) How shall the goods be produced, i.e., how should the resources be combined to produce the desired goods.
- (c) How the products are to be distributed, that is, who shall have the right to consume and in what quantities.

(d) How goods are to be rationed over periods during which supplies are fixed.

(e) What should be the rate of capital accumulation in order that the productive capacity of the economy can be maintained and expanded.

An economic problem would still not exist in the use of resources if man did not establish some goals for the outcome of the utilization of these resources. In general, terms the over-all goal of economic activity can be stated as a maximum of human welfare in the period of time under consideration. Once that a goal of maximization has been introduced then immediately it becomes obvious that certain patterns of resource use will be more desirable than others. Without some kind of a goal in terms of the outcome of resource utilization, we have no criterion for preferring one means of allocating resources to any other pattern of allocation.

Two important characteristics of modern economies must also be considered at this point in the development of the argument. It can be stated without qualification that any economy today, in solving the five choice problems stated above through the use of economic resources, and attempting to achieve high levels of income from these resources, will of a necessity have to resort to a complex pattern of division of labor. In other words, high levels of incomes can only be obtained as a result of specialization of resources. Adam Smith explained clearly the role of division of labor in the economic process and for the purpose here

no additional attention needs to be given to this characteristic directly. The importance of specialization for this argument is the nature of the complex pattern of exchanges that necessarily stem from a process of division of labor. It can further be stated that in order to achieve the complex pattern of exchanges necessary to employ a high degree of specialization and division of labor, a monetary exchange system must be employed. Within the climate of monetary exchange the individual member of the society exchanges his contribution to economic activity for units of purchasing power which he can in turn exchange for the individual goods and the quantities of each good that he desires within the limits of his purchasing power. Therefore, in summary, it can be re-emphasized that a modern economy seeking a high level of income from its resources will be characterized by specialization and monetary exchange and thus a system of prices which are merely the rates at which money is allowed to exchange per unit of good or service.

Price As A Choice Indicator

What Goods to Produce and How Much of Each. In determining what shall be produced and in what quantities, the economy must decide how the resources are to be allocated among the different possibilities. Should steel currently available be used for the production of automobiles or the construction of an elevator for storing food grains? How much land should go into jute production and how much into rice? Should skilled labor go into machine shops or the building of dams? The problem is one of choice, and therefore, there is the need for a choice indicator. In this

instance the relative prices of the different commodities become the choice indicator.

The role of price can be made clear by the use of Fig. 1. The two axis represent two commodities that can be produced out of the resources available. The curve QR is the production possibility curve which indicates the quantities of the two goods that can be produced from a given amount of resources. The straight line n_2n_1 represents the ratio of the prices of good x_2 to the price of good x_1 . The optimum output of the two goods from the given quantity of resources available is at the point of tangency of the price ratio line and the production possibility curve, or point T with the resulting output of OA of good x_2 and OB of good x_1 .

How Shall the Goods be Produced. In determining the combination of resources to be used in the production process, the decision will have to rest on the relative resource prices and the quantity of the product to be produced. A product can be produced in a multitude of ways depending on the particular combination of resources and techniques employed. Technical or physical considerations alone cannot define which particular pattern of resource use is economically the best. The most desirable combination of resources cannot be determined until a choice indicator is employed to indicate which of two or more alternatives is optimum or will maximize a given end. As has already been illustrated above, when two products which can be produced with given resources are compared, the choice indicator becomes the ratio of the price relationship between the two commodities. Similarly if two resources

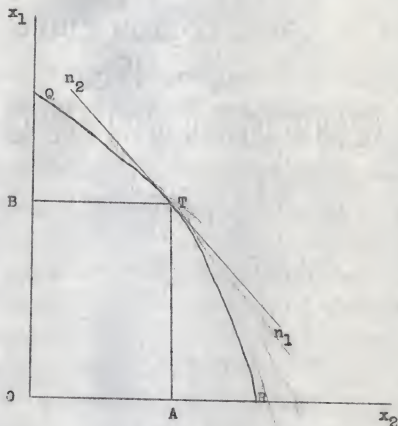


Fig. 1. An optimum allocation resource situation for two products.

are used to produce a given product, the choice indicator becomes the ratio of the prices of the factors involved. When two factors are employed in production of a single product, cost is at a minimum and the resource use is most efficient when the ratio of factor prices is inversely equal to the marginal rate of substitution of two factors. Thus if Z and X_L represent the marginal rate of substitution of factor X for factor Z and P_n and P_z represent the prices of the two factors, the most desirable combination of the two resources will be reached when $\frac{Z}{X} = \frac{P_n}{P_z}$.¹ If the price ratio P_n/P_z is less than the substitution ratio, costs can be lessened by using more of X and less of Z . On the other hand, if price ratio is greater than the substitution ratio, costs can be lessened by using more of Z and less of X .

It may be interesting to see, in terms of marginal productivity analysis, how resource prices furnish the mechanism for channeling resources from less important to more important uses. Resource prices are then the device for reallocation of the resources. Firms in which the value of the marginal product of a given resource is lowest will not be willing to pay more for the resource than its value of marginal product. On the other hand, firms in which its value of marginal product is highest can increase profits by expanding the quantity employed. The latter firms bid the resource price above the value of the marginal product in the former firms, thus directing the transfer of resources from the

¹Heady, Earl, Economics of Agricultural Production and Resource Use, Chapter VII.

lowest paying to the highest paying uses. In this manner prices direct resources towards most desirable uses.

How the Products are to be Distributed. Product distribution depends on personal income distribution and human wants. The prices received for services performed in terms of wages, salaries, etc., constitute income. The consumer uses his income to satisfy wants for food, clothes, shelter, entertainment, etc. Within the limits of his income, the consumer must make decisions regarding the allotment of funds to the general categories of wants and between the manifold items within each. These decisions are based in large measure on the prices for the items taken into consideration. With given product prices, the consumer seeks to allocate his income in such a way that the marginal utility per dollar's worth of one will be equal to the marginal utility per dollar's worth of another product. In terms of indifference curve analysis, each consumer seeks that combination of goods with his given income at which the marginal rate of substitution between any two equals the ratio of their prices.

Since product distribution depends on income distribution, those with larger incomes obtain a larger share of the economy's output than those with smaller incomes. Income differences may result from improper channeling of certain resources into the production process; from differences in resource ownership among individuals; from differences in skills or due to differences in desire for leisure time in lieu of their income. Differences in income can be reduced without materially affecting the operation

of the price system but redistribution of income will affect the goals of economic activity by changing the effective pattern of social designs for goods and services. The price system will re-organize production to conform with the new pattern of effective designs for goods and services.

Rationing of Goods During Periods of Fixed Supply. Supplies of certain commodities cannot be changed during a given time period. For instance, the supply of rice available for consumption would be fixed for one year from one harvest to another. During this time period, price will provide the mechanism for rationing the fixed supply first by allocating this supply among the consumers and second by spreading out the supply from one harvest to the next. When the fixed supply shows a shortage, price will increase, thereby reducing the amount which the consumer is willing to buy. Price will continue to rise until the available quantity is rationed among those willing and able to purchase. In other words, with a shift to the left of the supply curve, the price will increase and a new equilibrium will be reached at a higher point on the demand curve.

Over time also, price will be the device for rationing the fixed supply. Low prices at harvest time when market arrivals are at their peak will stimulate increased consumption. In the later part of the season, supplies will dwindle and prices will rise to ration this limited supply.

Determination of Capital Accumulation. Capital accumulation is necessary for the expansion of the productive capacity of the economy as well as maintenance of a given level of economic acti-

vity. The growth of capital depends on the volume of saving. This means that for capital accumulation to occur, some resources will have to be directed from the production of current consumption goods to the production of capital goods. This process is also effected through the pricing mechanism.

The marginal efficiency of capital is the rate of return to capital per monetary unit of additional capital invested in a given enterprise. Consequently, the extent to which investment can be justified or will occur is determined by the marginal efficiency of capital on one hand and the rate of interest for loan funds on the other. A lowering of the interest rates means that the period of time over which the returns of a fixed capital investment can be capitalized will be lengthened as well as promoting more extensive use of capital in the production process.

Pricing in a Free Enterprise Economy

Different types of economic systems perform these five functions in different ways. First, the theoretical operation of a "Free Enterprise," system will be discussed to illustrate how order is achieved out of individual actions through the mechanism of price within the institutional framework that marks the "Free Enterprise" system.

Theoretically, the "Free Enterprise" system is defined by the existence of the institutions of private property, inheritance, freedom of enterprise and competition. Furthermore, competition is defined as:

1. The existence of a large number of independent buyers and sellers.
2. A homogeneous good traded by groups of buyers and sellers.
3. Equal knowledge on the part of all buyers and sellers.
4. No restrictions or compulsions.

In brief, the outcome of economic activity is achieved through price relationships determined in the competitive markets. Under the conditions of competition outlined above, no one individual will be able to influence the price of any commodity directly. Instead price will be determined by both demand and supply in the competitive market. Demand will represent the force of the consumers desires for the various goods known to the society, and on the other hand, supply will be determined by the cost of production. However, in the end result the cost of production will in turn also reflect the consumers desires inasmuch as the value of factors in one use will be their alternative value in producing competing goods.

The argument is briefly as follows: Individuals, owning the means of production under the institutions of private property and inheritance, will utilize those resources in those lines of economic activity where they will yield the greatest income. The greatest income per unit of resource will be determined by prices offered for the use of the resources in the various industries, which will in the end result be determined by the intensity of the consumers desires within the framework of the competitive market. Therefore, in this manner the "free enterprise" system achieves

the allocation of resources to achieve a maximum of satisfaction out of the resources through direction given by competitively determined price relationships.

Prices in a Socialist Economy

In the modern world there is a wide variety of "isms" and alternative institutional systems which define the process of allocation of resources. At one extreme is the capitalistic system which is based on free enterprise, private property and competition; at the other extreme is the completely centralized type of state socialism in which the complete apparatus of guidance of productive operations and distribution of goods is invested in the hands of the government. Between these two extremes, there are different shades of "mixed economy" where varying degrees of state control are intermingled with market forces in organizing production and consumption. In reality it is impossible to arrive at either extreme position. All economies are "mixed" economies, those with somewhat greater centralized control gravitating towards the limiting position, and others with less centralized control, gravitating towards the other limiting position. If private monopoly control can be replaced by democratic governmental control, the end result would actually be gravitating towards a decentralized power structure.

In the preceding section the operation of the free enterprise system was discussed. It is the purpose of this section to describe the process of allocation of resources under the institutional arrangement of socialism.

At the extreme, in the completely centralized type of socialism, there is neither freedom of choice in consumption nor freedom of choice in occupation. In such a system, the allocation of resources is directed, not by the preferences of the consumers, but by the judgment of the socialist planners. The Central Planning Board decides which commodities are to be produced and in what quantities. The consumer goods produced are distributed by rationing while the various occupations are filled by assignment. The classic example of this type of economic arrangement was the system established in Russia in 1919 at the close of the Bolshevik Revolution. However, as indicated earlier in this study, characteristics of a modern economy necessitate specialization and use of a monetary exchange in the economic process. The necessity for these was portrayed by the failure of the attempt to operate a modern economy without a monetary exchange system and the New Economic Plan of 1924 reinstated money and monetary exchange in the Russian economy.

Recent Socialist writers have proposed an organization in which freedom of choice in consumption and in occupation are allowed and in which the preferences of consumers are allowed to be a guiding force in the allocation of resources. The state assures each person a given money income and also authorizes him to spend that income in any way he chooses in buying the commodities produced by the state. The consumers are thus in a position to direct what commodities the economic authorities of the state should produce. The market prices are set by the state with the same

double purpose as in a capitalistic society, i.e., (1) just high enough to ration out the existing supplies of consumer goods so none are left over and none are short, and (2) also just high enough to cover the socially necessary extra costs of producing the goods in question. In other words, prices are set equal to relative "marginal utilities" and "marginal costs."

In the case of capital goods and productive resources, there is no market in a socialist economy. The socialist planners themselves, attempt to perform the function of the market. They fix prices of these resources and the managers of production and of productive resources are directed to do their "accounting" on the basis of these prices. These "accounting" prices are intended to provide the basis for finding the combination of factors that will minimize the average cost and the scale of output that will equalize marginal cost with the price of the products. The accounting prices are found by a process of trial and error. Since the decisions of the producers, i.e., the managers of production and or productive resources, as also of consumers are made on the basis of these prices, the quantity demanded and supplied of each commodity is determined. If the quantity demanded of a commodity is not equal to the quantity supplied, the price of that quantity demanded and supplied of each commodity is changed. It is raised if the demand exceeds supply and is lowered if the reverse is the case. Thus a new set of prices is found which serves as a basis for new decisions and which results in a new set of quantities demanded and supplied. The process of trial and error is

combined till a point of equilibrium is reached where the quantity demanded is equal to the quantity supplied. The socialist planners' claim that the same trial and error procedure which satisfies the equilibrium condition in a competitive market also determines the equilibrium condition in the socialist economy and that it is possible to substitute planning for the functions of a market.¹ There is disagreement on this point among various writers in economic theory. At the outset one can point out the scope of the task of the planners to approach the accomplishment of the market. In the consumers market alone, the planners must consider $n(n-1)$ equations of price relationships to arrive at equilibrium, where n is the number of commodities involved in the consumers market. It is not the purpose of this report to choose between the two sides of this argument and take a firm stand whether or not planning can perform the complete functions of the market. This problem is dealt with in Chapter 6 where the author proposes what he considers to be a realistic approach to the controversy for the purpose of economic development in India.

In a socialist economy, it is left to the planners to set wage rates also. If the amounts of labor of all kinds and of all skills were perfectly known, perhaps the planners could find "accounting" prices for labor like any other productive factor. But since freedom of choice of occupation is allowed and there are differences between occupations, the socialist planners set up actual market wages at which people offer their services. Some

¹Lange, Oscar, Economic Theory of Socialism, pp. 86-87.

jobs are more irksome than others and higher wages are necessary to attract people from "more pleasant" to "less pleasant" jobs. Similarly, occupations that require much training and skill receive higher pay. Thus in a socialist economy also, wage rates differ in order to provide incentives and compensate people for differences in occupations. The socialist planners claim that wage rates can be determined which are equal to marginal productivities and disabilities.

PRICE SYSTEM IN INDIA

Characteristics of the Economy

India is a large country with a geographical area of 1260 thousand square miles and a population of 400 millions. The density of population in India is 287 per square mile as against 51 in the USA, 71 in Burma and only 4 in Canada. Of the total population of 400 millions, about 280 millions, or 70 percent, are directly dependent on agriculture over a cultivated area of about 300 million acres. The per capita cultivated area is about 1 acre in India as compared to 4.5 acres in the U.S.S.R. and 7.4 acres in the U.S.A. The process of subdivision and fragmentation of land has resulted in a multitude of tiny holdings. Only 17 percent of the cultivated area enjoys irrigation facilities whereas the rest must depend on the monsoon which is notoriously erratic.¹

In India, agriculture supports about 70 percent and industry 30 percent of the population; in the U.K. about 95 percent of the

¹Government of India, Ministry of Food and Agriculture, Indian Agriculture in Brief, pp. 9-14.

population are engaged in industry and only 5 percent in agriculture. In the U.S.A. 75 percent of the population depended on agriculture about a hundred years ago but so rapid has been the progress of industrialization in this country that currently 90 percent of the population derive their earnings from industry and only about 10 percent are dependent on agriculture.

The dependence of a dense population on agriculture has led to the emergence of the vicious circle of low income, low investment, and low productivity. Large numbers of workers on land are redundant; they do not add to the total output but share with other members of the family whatever is produced. The productive workers thus "save" a portion of their real income in order to maintain the unproductive or "disguised" unemployed persons in the family, thus average per capita income is lower than the real per capita income per productive worker.

Since agriculture in India is the main occupation of the bulk of the people, the low income in agriculture is reflected in the national income. The per capita national income in India has been estimated at Rs 267 (\$56) as compared to \$114 in Ceylon, \$96 in Japan, \$852 in U.K., and \$1850 in the U.S.A. If farm income is taken into consideration, the average per capita income of the farm worker is about Rs 200 (\$40) in India as compared to \$800 in the U.S.A.¹

The under-developed economy in India is, however, a legacy of the past. Just before the advent of British rule in India, the

¹Ibid, p. 15.

Indian economy had lost momentum and was fast settling down to a semi-static equilibrium condition. The position did not improve after the British occupation of this country. Britain was interested in India particularly because the India economy provided a vast market for British manufactured goods and a source of food and raw materials for the West. Britain was interested in directing the development of India in a manner which would make it complementary to Britain's own economy. She was not keen on effecting an all-round economic development in India. Throughout the British occupation, Indian agriculture lacked sufficient capital; the technique of cultivation did not change appreciably and there was little use of machinery in farming. In the field of industry, there was no progress at all during the first hundred years of British rule in India. Since then, a small industrial sector emerged in the economy out of sheer necessity arising from the first and second World Wars. The British did not encourage the setting up of heavy basic industries in India probably because these industries could create a solid capital base for the Indian economy and would be competitive with, rather than complementary to, Britain's own economy.

Problems Confronting Independent India

When, in 1947, Britain left India, the country showed all the distressing characteristics of an under-developed economy-- low productivity, under-employment, unemployment, low income and a low standard of living. The problem confronting independent

India was to accelerate economic growth, to open out opportunities for gainful employment, and to improve the well-being of the masses of the population. The constitution of free India in its directive principles of state policy laid down that "the state shall strive to promote the welfare of the people by securing and protecting as effectively as it may, a social order in which justice, social, economic and political, shall inform all the institutions of the national life." Soon after this, the Parliament of India gave a more concrete shape to this declaration by accepting the Socialist pattern of society as the objective of social and economic policy. This meant that the best criterion for determining the lines of advance was not private profit but social gain. The benefits of economic development should accrue more and more to the relatively less privileged class of society. Efforts should be made for a progressive reduction in the concentration of income, wealth, and economic power. An economic foundation should be laid down which would enable the common man to put in his best in the interests of a higher standard of life for himself and increased prosperity for the country.

Mixed Economy: The Public Sector and the Private Sector

In order to create these conditions, it was felt that the state should assume a progressively active role and take on heavy responsibilities as the principal agency speaking for and acting on behalf of the community as a whole. This did not mean that private enterprise was to be eliminated. On the contrary, in the interest of the country's developing economy, the need was felt

for the development and expansion of private enterprise. There would be two sectors--the public sector and the private sector but the two should act in cooperation for the economic development of the country as a whole.

The Socialist pattern established thus provided for a mixed economy with an expanding public sector and a developing and co-operating private sector. Broadly, the private sector comprises agriculture, cottage and small industries while the public sector comprises largely heavy industries, public utilities, transport, etc. As a further clarification of the role of the public sector, the Government of India in 1956 announced its industrial policy resolution classifying industries into three categories and making a selection of those industries in the development of which the state would play a dominant role. The first category consisted of those industries for which the state would assume the exclusive responsibility for development. This category included 17 major industries such as arms and ammunition, atomic energy, iron and steel, heavy machinery, coal, mineral oils, aircraft manufacture, air and rail transport, ship building, telephone, telegraph and generation and distribution of electricity. All new units in these industries, save where their establishment in the private sector had already been approved, would be set up by the state. This did not preclude the expansion of the existing privately owned units or the possibility of the state securing the cooperation of private enterprise in the establishment of new units when the national interests so required. Railways and air transport,

arms and ammunition and atomic energy would, however, be developed as Central Government monopolies.

The second category included 12 industries which would be progressively state owned and in which the state would take the initiative in establishing new undertakings but in which private enterprise would also be expected to supplement the efforts of the state. Of the twelve industries included in this category, the most important ones were aluminium, ferro-alloys, machine tools, antibiotics, fertilizer, synthetic rubber, chemical pulp and road and sea transport. The state would establish new units in the 12 industries included in the second category but also would provide private enterprise opportunity for investment in this field, either on its own or through state participation. Thus the second category included industries which would be both privately and publicly owned and which would receive fair and non-discriminatory treatment from the state.

The third category, which included all the remaining industries, was left to the initiative and enterprise of the private sector for development.

The division of industries into separate categories did not, however, imply that they were placed in water-tight compartments. Naturally, there would not only be an area of overlapping but there would also be a good deal of "dove tailing" between industries in the private and public sectors. Heavy industries in the public sector could obtain some of their requirements from the private sector while the private sector could rely for many of

its needs on the public sector. The same principle applied with even greater force to the relationship between large scale and small scale industries.

Government Policy in the Public Sector

The question of efficient organization and management of public enterprises has been engaging the serious attention of the Government of India particularly in view of the increased importance assigned to the public sector. Opinion was sought in this connection from two distinguished American economists, Professor J. K. Galbraith and Dr. Paul Appleby. Professor Galbraith's first suggestion was in favor of autonomy of State-enterprises. In his opinion the Government should seriously consider whether it would not be wise to limit the scope of parliamentary control on details of business practice and decisions taken by public enterprises. Dr. Appleby agreed with Professor Galbraith and warned that an "inquisitional parliament would make public enterprises more cautious and less action minded." Another suggestion of Professor Galbraith was the promotion and management of industrial enterprises through multipurpose corporations like the Zaibabsu in Japan and the General Motors Corporation in the U.S.A.

While it is generally agreed that the setting up of multipurpose corporations would economise the use of managerial talent and technical personnel, there are some who feel that "allied purpose corporations" would serve India's interests better. Each "allied purpose corporation" could contain a number of medium-

sized units whose activities would be co-ordinated by a general supervisory and integrating board. The price and output policies of various units within the corporation could be compared and the most efficient unit producing best quality product at minimum price should serve as the optimum unit. The price and production policies of the optimum unit should provide a guidance to other units. The advocates of the "allied purpose corporation" feel that this should facilitate management and the promotion of a number of optimum units in the same industry.¹

The Government of India has also formed an Industrial Management Research unit for planning. This unit studies and reports not only on the organizational structure most suited for each state enterprise but also examines methods for optimum utilization of resources by industrial undertakings and studies other problems of industrial planning.

Government Policy Towards the Private Sector

Industrial Sector. In its Industrial Policy Resolution of 1956, the Government declared its intention to facilitate and encourage the development of industries which have been left to the initiative and enterprise of the private sector by ensuring the development of transport, power, and other services and by appropriate fiscal and other measures. Actually, the State encourages the promotion of institutions which provide financial aid

¹Ghosh, Alak, Indian Economy - Its Nature and Problems, pp. 227-228.

to these industries and special assistance is given to enterprises organized on cooperative lines for industrial and agricultural purposes. In suitable cases, the State also grants financial assistance to the private sector.

While the Government of India recognizes the desirability of allowing industries in the private sector to develop with as much freedom as possible, these industrial undertakings must necessarily fit into the framework of the social and economic policy of the State. Accordingly, the Government passed the Industries (Development and Regulation) Act which provides the institutional framework within which development in the private sector is to be undertaken.¹ All new undertakings and substantial expansion of existing undertakings are licensed under the Act, which also provides for the setting up of Development Councils for individual industries. Forty-two industries are now within the scope of this legislation and development councils have been constituted for ten industries. Besides, the Government has established the National Industrial Development Corporation, the Industrial Credit and Investment Corporation and State Finance Corporations so as to be able to control, direct and guide industrial development in accordance with approved objectives.

Price Policy: Some Large Scale Industries

Iron and Steel Industry. The iron and steel industry made a beginning with the establishment of the Tata Iron and Steel Works

¹Planning Commission, Government of India, Second Five Year Plan, p. 110.

at Jamshispur in 1907. The domestic production of steel together with the limited supplies available by way of imports fall far short of requirements. This shortage of supply has necessitated the imposition of price control on steel. Under the "retention price" policy, the Government fixes a "retention price" at which the main producers supply steel. The selling price to the consumer is higher than this "retention price." The difference between the selling price and the "retention price" goes to an Equalization Fund, out of which payments are made for subsidizing imports of steel and for financing the renovation and modernization programs of steel producers.

Coal Mining Industry. The coal mining industry has recorded significant increases in production since 1930. The output is expected to rise further, but the productive efficiency of the coal mining industry is low and the need has been felt for the early mechanization of this industry.

The coal industry is different from other industries in that labor accounts for a high percentage of the cost in this industry. The Government has imposed price control on coal mainly because the industry can fulfill its responsibilities for fixed labor charges only if it is assured of a reasonable price for its product. The controlled price for coal is not "ceiling price" but is more in the nature of a price floor. The producer cannot sell coal below this fixed price nor can the consumer be asked to pay more than this price. Although the industrial consumers have requested that the fixed price should be treated as "ceiling price,"

the Government has been unable to accept this position. In the Government's opinion, "if the collieries are allowed to sell below the ceiling prices, the only result would be that there would be an unhealthy competition and the weaker and marginal mines would go out of production. Once collieries are closed, it would be difficult to re-open them and it would not be in the national interest to allow such a thing to happen in view of the fact that coal production has to be maintained to keep other industries engaged."

The "fixed" price can be thought of as an "economic" price in view of the fact that the price of coal is linked primarily with the cost of labor, thus any upward revision in wages necessitates a "compensating" increase in the coal price which becomes the new "economic price."

Jute Industry. The jute industry is localized in Calcutta and owned largely by British managing agents. Partitioning of the county in 1947 dealt a severe blow to this industry due to the fact that East Bengal, which was the major jute producing area, now became a part of Pakistan which in turn established its own jute mills. The main problems facing the industry are the shortage of raw materials and modernization of plant and equipment. Attempts are being made to increase domestic production of jute but the jute industry is still faced with the problem of availability of raw jute of suitable varieties at economic prices. Again, the existing machinery of the jute industry is to a large extent worn out and obsolete with the result that production has become uneconomic and it is becoming difficult for

India to compete with lower priced jute goods produced by new mills set up in Pakistan and other foreign countries.

The Government of India has set up a Development Council for the jute manufacturing industry to advise on the question of modernization of plant and other allied problems facing the industry. The internal market for jute goods is limited and prices are influenced by demand for these goods in foreign markets. The Government has not fixed any minimum price for raw jute in view of the uncertainties of the prices of jute goods, but attempts are made to insulate the internal market from the effect of variations in the world market for jute goods through adjustments in import quotas and duties for jute goods and alterations in active loomage and working hours per week in mills.

Cotton Mill Industry. The cotton mill industry in India was granted protection in 1927 and during twenty years under protection, it made considerable progress. In 1947 protection was withdrawn.

Price control for cloth was first imposed in 1943 and a Textile Control Board was set up to deal exclusively with matters relating to prices, production, and standardization of varieties. These controls were withdrawn in 1953 following an improvement in the supply position of cloth. Prices of cotton are, however, controlled by the Government, through the fixation of floors and ceilings and the regulation of futures trading. Indirect measures for stabilizing the prices of cloth include the four-fold mechanism of quantitative export control, export duties, quantitative import

control, and import duties. Varying the excise duty on cloth is also another device for imparting stability to the internal market.

Sugar Industry. The sugar industry in India has shown a remarkable expansion during the last twenty-five years. After the outbreak of World War II, prices of sugar showed a sharp increase due partly to increased demand for Indian sugar from allied countries and partly to transport bottlenecks within the country. Controls on the supply and prices of sugar were imposed by the Government in 1942. In 1952, sugar was decontrolled but the Government retained its authority to regulate releases from factories and to keep 25 percent of the production of sugar in reserve with the mills for meeting any emergency. Exports or imports of sugar are made on Government account only.

Price Policy in Agricultural Sector

Before the outbreak of World War II in September 1939, the Government of India followed a policy of laissez faire and prices were allowed to be determined by the free play of supply and demand. The sharp rise in prices during the War and the growing imbalance between supply and demand necessitated state intervention and direct or indirect regulation of market forces.

Broadly, agricultural price policies in India have reflected recognition of the need to prevent, on the one hand, a decline in producers prices to uneconomic levels, and on the other hand, any hardship to consumers from high prices. The conditions obtaining

during a particular period have determined which of the two facets of this policy should receive greater attention. For about a decade during and after the War, price policy was mainly directed towards protecting the consumer interests; for practically two years thereafter, between mid-1953 and mid-1955, the emphasis shifted towards producer relief; thereafter, the accent of policy again shifted in favor of the consumer. Even when the interest of the consumer was the main concern of Government's price policy, producer interest was not lost sight of.

The methods of price control or regulation have not been uniform for all agricultural commodities. In the case of food grains which account for roughly two-thirds of the expenditure of an average household in India, even direct physical controls and direct price support have been found to be necessary while in the case of commercial crops, the accent of policy has been on indirect regulation of the market through adjustments in export/import quotas and duties.

Price Policy for Foodgrains. During the period 1944-1951, when prices of foodgrains showed a sharp increase, the Government's price policy was directed towards mitigating the hardship of the consumers. Soon after the tragic Bengal famine in 1943, a system of direct physical control over supply, distribution, and prices of foodgrains was in operation. The supplies available from imports and domestic production were distributed by the Government through a network of ration shops at specified retail issue prices. The retail prices were fixed primarily in con-

sideration of the consumer's cost of living; but, at times, when the economic cost of imported and internally procured foodgrains happened to be too high, compared to the incomes of the population, a consumer subsidy was also given. Issue of foodgrains at these prices gave direct relief to the consumer in rationed areas where a free market in foodgrains was not permitted. Even in areas not fully rationed and where open market in foodgrains was allowed to function along with Government distribution, issue prices exercised an indirect regulatory influence on open market prices. In 1951, when expenditure by way of consumer subsidy and imports was at its peak, food distribution at specified retail issue prices was undertaken by Government for 122 million persons. Roughly, half of the total foodgrains trade in the country was then handled by Government.

The year 1952 witnessed a transition from a seller's to a buyer's market and the beginning of decontrol of foodgrains. By the middle of 1954, controls were virtually withdrawn and there was once again a revival of the free market in foodgrains. Prices of foodgrains, however, began to show a sudden fall in 1954 and at places, they dropped to uneconomic levels. During 1954-55 the Government adopted a policy of price support for major foodgrains and actually purchased wheat and sorghum to import stability to the internal market.

From the middle of 1955, prices of foodgrains again began to harden and Government's attention was directed towards the stabilization of retail food prices. Although rationing was not re-intro-

duced, foodgrains were again issued through fair price shops in vulnerable areas at specified retail issue prices. At times the Government released stocks directly in the market. These measures were no doubt supplemented by a series of other regulatory measures, such as a ban on exports, restrictions on internal movement, licensing of foodgrain dealers, etc.

Commercial Crops - Sugar Cane. Among the commercial crops, mention may be made first of sugar cane for which the government has maintained a minimum price since 1935. The guarantee of a minimum price applies to all sugar cane delivered to sugar mills. During the War and a few years thereafter, when the price of sugar was controlled, the cane grower was assured not only of a minimum price but also of a reasonable share in the sale price of sugar. Even after the withdrawal of price control on sugar, attempts were made by the Government to link the price of cane with the market price of sugar. A quality basis for the purchase of sugar cane has been established so that the cultivators delivering superior quality of cane may be assured of a price higher than the minimum fixed on the basis of weight alone.

Cotton. Cotton is another commercial crop for which both floors and ceilings have been maintained since 1942. The floor price is intended to provide an incentive to the producers of cotton while the ceiling price is designed to prevent an undue rise in the price of cloth and other forms of textiles and thus impart stability to the textile industry.

Adjustments in Export-Import Quotas and Duties. Apart from price-fixation, which has been limited to foodgrains, sugar cane and cotton, stability in agricultural markets has been promoted through regulation of foreign trade in agricultural commodities. This is done through adjustments in export-import quotas and duties. Export of agricultural commodities is regulated through a system of quotas which are fixed and announced from time to time after taking into account the internal supply and demand situation. In a year of low production, export is banned or highly restricted, while relatively liberal export quotas are announced when output is in surplus relative to internal requirements.

Most of the major agricultural commodities are subject to quantitative export control. Export of foodgrains has been prohibited completely since 1943, except for a short period during 1954-55. In the case of oilseeds, the general policy has been to allow exports in the form of oils rather than oilseeds. In the case of cotton, only short-staple and certain medium-staple varieties are allowed to be exported. The policy in regard to all these commodities varies from time to time, the degree of restriction on exports depending on conditions of internal supply, changes in internal and international demand, and the necessity of conserving stocks of essential raw materials.

The stabilizing influence of export control is dependent largely on the intensity of demand in foreign countries and the proportion of exports to total output. It is only when exports

are sizeable in relation to total output that some influence on internal prices can be exerted by varying the quantities allowed for export. In the case of raw cotton and some oilseeds, exports do represent a sufficiently large percentage of output to make export control an important factor in lending internal stability to the prices of these commodities.

Adjustments in import quotas and duties are also intended to maintain a balance between internal demand and supply and contribute to stability of prices. Among commercial crops sizeable imports are made of long staple cotton, particularly from the U.S.A. and of raw jute from Pakistan. By a suitable change in import quotas and duties the Government endeavors to counter adverse market forces and to stabilize internal prices of these commodities.

Thus in summary it can be stated that because of the nature of the problems of economic development facing India, a "mixed economy" was chosen as the optimum means of achieving the necessary development at the fastest possible rate and with the minimum waste of resources and effort. This mixed economy comprises of a public sector which is limited to heavy industries, transportation and communications; a semi-private sector, comprised primarily of light industry and some basic industry as well in which the government establishes firms but at the same time encourages and assists private investment; and a strictly private sector comprised mainly of agriculture which is left entirely to private incentive and enterprise but at the same time receives assistance from the government through credit programs, the extension service

and basic services such as power, transportation, and so forth.

Within the framework of this mixed economy the government uses the price mechanism as a guiding force in directing the allocation of resources towards the planned goals of development. When the need arises, regulation of market forces is considered necessary rather than leaving prices to be determined by the vagaries of an uncontrolled market. Thus the price system is a combination of free and administered prices, with price administration being employed when deemed necessary to realize the defined ends of the Plan. Administration may range from direct fixation of price to indirect regulation of market forces through monetary and fiscal policy, credit control, and adjustments in export and import quotas and duties.

INDIA'S FIVE YEAR PLANS

Even before India attained independence, there was a popular urge for formulating a systematic plan for the economic reconstruction of the country. As early as 1934, a renowned Indian statesman published a book entitled, "Planned Economy of India." Nine years later, eight leading industrialists of Bombay prepared another "Plan for Economic Development in India." In 1944, the Government of India actually set up a department for Planning and Development with one of the authors of the Bombay Plan as the member-in-charge. It was, however, only after the attainment of independence in 1947 that the possibilities of planning could be fully realized and translated into action. In 1950 a Planning

Commission was set up in India with Mr. Nehru, the Prime Minister, as the Chairman. In July 1951, the nation was presented with the First Five Year Plan.¹

Planning is considered to be the sine-gua-non for an underdeveloped economy. Productivity and income in such an economy are so low that only planned and concerted action can lift the economy out of the morass of poverty and its semi-stagnant condition. The need is felt for an accelerated economic growth. The underdeveloped country has to encompass, within a relatively brief period, processes of development which took generations in other countries with an earlier start. The whole structure of the economy has to be changed on a scale and with a speed which is felt would not be possible of achievement by private enterprise. Considerable investments are needed in the initial stages, particularly on heavy industries and transport which bring no immediate profit and which are consequently unlikely to be forthcoming from private entrepreneurs. Besides, there are so many unknown risks and so many uncharted territories to conquer that private risk bearers cannot be expected to plan their operations. Opinion is, therefore, almost unanimous in India that the State should formulate an economic Plan for the development of the resources of the country as a whole.

It must be mentioned, however, that planning in India is different from planning in a totalitarian state. Whatever merits a

¹ Ghosh, Alak, op. cit., pp. 51-52.

totalitarian state may possess in respect to successful implementation of an economic plan, such "success" has been at the expense of certain basic values which are highly prized in many countries. It has involved the denial of personal freedom and other democratic rights of the people. Planning in India, on the other hand, is formulated and executed within the framework of democracy. Free market mechanism continues to play a distinct role under India's democratic planning. The object is to supplement rather than supersede the "self-regulating automatic system, based solely on competition and private enterprise." The Plan works within the framework of a "mixed economy" in which state enterprise functions side by side with private enterprise and in which the two sectors operate in unison and as parts of a single mechanism. The progress of the Plan is dependent on simultaneous and balanced development in both sectors.

When the First Five Year Plan was prepared in 1951, the main object was to lay the foundations on which a more progressive and diversified economy could be built up. There were certain urgent problems such as shortages of food and raw materials and persistent inflationary pressures which required immediate attention. But essentially the Plan was intended to prepare the ground for more rapid advancement in the future. The problems of the economy were viewed in the context of long range requirements. Development programs were worked out to meet immediate needs but at the same time, the need for a balanced and all-round economic development was kept in view.

The progress achieved during the First Plan period was quite encouraging and paved the way for including more ambitious and diversified development programs in the Second Plan. Prices were reduced to reasonable levels. The targets of production set out in the First Plan were mostly realized and were even exceeded in the case of some commodities. Some 17 million acres of land were brought under irrigation and the installed capacity for generation of power was increased considerably. A large number of industrial plans both in the public and private sectors went into production. National income was estimated to have increased by 18 percent during the five year period. A gratifying feature was that all this development was achieved without excessive strain or imbalances developing in the economy. The Plan evoked enthusiastic cooperation of the people; "it created in them a longing for a new order of things and determination to work for it."

The Second Plan (1955-56 to 1960-61) was prepared to take advantage of the gains secured under the First Plan and to carry forward the thread of progress initiated during the First Plan period. It was aimed at securing a more rapid growth of the national economy and at increasing the country's productive potential in a way that will make possible accelerated development in the succeeding plan periods. To this end, resources had to be mobilized and deployed effectively and purposefully. The essence of planning in development is a coordinated use of the real resources available for the achievement of defined aims. Development also involves the adoption of new techniques and strengthening of the institutional framework of society.

Within the broad approach indicated above, the Second Five Year Plan was formulated with the following main objectives in view:

- (a) A sizeable increase in national income in order to raise the level of living in the country;
- (b) rapid industrialization with particular emphasis on the development of basic and heavy industries;
- (c) a large expansion of employment opportunities;
- (d) reduction of inequalities in income and wealth and a more even distribution of economic power.

These objectives are inter-related and have to be viewed as part of an integrated plan for the balanced development of the economy.

An appreciable increase in national income and a marked improvement in living standards could not be secured without a substantial increase in investment and production. To this end, it became vitally necessary to explore and develop minerals and to promote the expansion of heavy industries. For securing a simultaneous advance in all directions, the best possible use had to be made of available manpower and natural resources; and in a country where there is relative abundance of manpower, expansion of employment opportunities became an important objective in itself. Further development had to be achieved through democratic means and processes and in such a way as would result in a diminution of economic and social inequalities.

Outlay and Allocations

Public Sector. The total developmental outlay of the Government for the Second Five Year Plan period together with its distribution by major heads of development is indicated below. In the discussions that follow, outlay has been indicated in crores of rupees. A crore represents 10 millions while a rupee, which is the legal tender in India, is equivalent to 21 cents.

Table 1. Proposed Investment Expenditure for the First and Second Five Year Plans, India.¹

| | First Plan | | Second Plan | |
|---|------------|-----------|-------------|-----------|
| | : Proposed | | : Proposed | |
| | : Outlay | : Percent | : Outlay | : Percent |
| Agriculture and Community Development | 357 | 15.0 | 568 | 11.8 |
| Irrigation and Power | 661 | 28.1 | 860 | 17.9 |
| Transport and Communications | 557 | 23.6 | 1345 | 28.0 |
| Industries and Minerals | 179 | 7.6 | 1080 | 22.6 |
| Social Services, Housing and Rehabilitation | 533 | 22.6 | 863 | 18.0 |
| Miscellaneous | 69 | 3.0 | 84 | 1.7 |
| Total | 2,356 | 100.0 | 4,800 | 100.0 |

The Second Plan is in a sense a continuation of the process of development commenced in the First Plan but the priorities which underlie these allocations in the Second Plan reflect a clear shift in emphasis on industrialization. Rapid indus-

¹Planning Commission, Government of India, Second Five Year Plan, p. 22.

trialization is the core of development in an underdeveloped economy. Within industry itself, high precedence has to be given to the development of basic industries such as iron and steel, non ferrous metals, coal, cement, heavy chemicals, and engineering.

The emphasis on industrialization has necessitated large investments in transport and communications. The transport sector of the economy includes railways, roads, ports and harbors, inland water transport, shipping, and civil air transport. Communication services include posts and telegraphs, overseas communications, broadcasting, and meteorology. The development of transport and communications is a "conditioning factor" in the process of industrial development. As the economy develops rapidly, there is a growing need for the expansion of transport facilities and communication services.

It was realized that the large programs of investment proposed for the Second Plan period would create new incomes, a significant proportion of which would be spent on food. Likewise, the demand for raw materials would increase with industrialization. Agricultural re-organization and rapid agricultural development was, therefore, absolutely necessary for sustenance of accelerated industrial growth. Therefore, suitable provision was made for increasing irrigation and power which are of importance to agriculture as well as industry.

Private Sector. The likely level of private investment over the Second Plan period estimated mainly on the basis of the broad investment trends over the preceding five years and the

known investment programs in certain lines has been placed at Rs. 2400 crores, the distribution of the proposed investment being as follows:

Table 2. Estimated Investment to be made in the Private Sector During the Second Plan Period.¹

| | Rs. Crores |
|--|------------|
| 1. Organized industry and mining | 575 |
| 2. Plantations, electricity undertakings and transport other than railways | 125 |
| 3. Construction | 1,000 |
| 4. Agriculture and village and small-scale industries | 300 |
| 5. Stocks | <u>400</u> |
| Total | 2,400 |

In the First Plan, total investment in the economy was estimated at Rs. 3,100 crores, the ratio of public to private investment being 50:50, in the Second Plan, the target of investment in the two sectors combined is Rs. 6,200 crores, the ratio of public to private investment being 61:39.

Physical Targets and Production and Development. It is customary to describe a Plan in terms of financial outlays but essentially a Plan is an embodiment of the concrete tasks to be completed within a specified period. These tasks involve the application of certain inputs (labor, plant, machinery, specialized skills, etc.) and the realization of certain outputs (food, raw materials, consumer goods, etc.). The magnitude of the task under-

¹ Reserve Bank of India, Report on Currency and Finance, 1955-56, p. 85.

taken and the significance of the results expected to be attained can, therefore, be appreciated better in real terms.

In terms of physical targets of production and development, the Plan envisaged an increase of 28 percent in agricultural production. The production of foodgrains was to be increased by 25 percent, from 65.0 million tons in 1955-56 to 80.0 million tons in 1960-61. This was to be achieved by increasing the area under irrigation by 21 million acres.

The capacity for electric power generation was to be doubled. The railways were expected to equip themselves to handle a 15 percent increase in tonnage. The community development program was proposed to cover the entire rural area and benefit a population of 325 millions. The public sector of industry and mineral development was to be expanded considerably. For instance, the production of finished steel was proposed to be increased by 231 percent from 1.3 million tons to 4.3 million tons and iron ore by 191 percent from 4.3 million tons to 12.5 million tons. It was also intended to accelerate the programs of development in respect to heavy industries, oil exploration, and coal and to make a beginning with the development of atomic energy.

The above were the developments envisaged in the public sector. These are to be considered in relation to the programs included in the private sector. The increase in the output of goods and services to be secured over the Plan period will naturally be the result of the combined developments in both the sectors. However, when investment decisions and corresponding outputs for

the public sector can be estimated within reasonably narrow limits, the results to be forthcoming from the private sector could only be postulated within broad limits.

Financing of the Plan

The success of a Plan depends on the efficiency with which the necessary resources are raised, and in a democratic system, finance is the major instrument for raising and directing resources. For implementing a Plan with a proposed outlay of Rs. 6200 crores, fiscal policies have to be adopted which will add to the resources of the Government. Further, the problem of mobilizing resources has to be viewed in the light of the requirements of both the public and private sectors as they both draw upon the same pool of real savings. While the basic issue is the mobilization of domestic savings to the desired end, the necessity of importing machinery and equipment from abroad also presents the problem of administering foreign exchange resources.

Finance for the Public Sector. The following table sets out the scheme of financing for the public sector as envisaged under the Plan.

Table 3. Estimate of Resources for Financing the Second Five Year Plan.¹

| (Crores of Rupees) | | | |
|--------------------|--|-----|------|
| 1. | Budgetary Resources | | |
| (a) | Surplus from current revenues | | 800 |
| (1) | At 1955-56 rates of Taxation | 350 | |
| (2) | Additional Taxation | 450 | |
| (b) | Borrowing from the public | | 1200 |
| (1) | Market loans | 700 | |
| (2) | Small savings | 500 | |
| (c) | Other budgetary sources | | 400 |
| (1) | Railways contribution to the development programs | 150 | |
| (2) | Provident funds and other deposit needs | 250 | |
| | Total Budgetary Resources | | 2400 |
| 2. | Resources to be raised externally | | 800 |
| 3. | Deficit financing | | 1200 |
| 4. | Gap - to be covered by additional measures to raise domestic resources | | 400 |
| | TOTAL | | 4800 |

From the above table it is evident that the budgetary resources that can be raised through taxation, borrowing and other receipts amounts to Rs. 2400. A further Rs. 1200 crores are proposed to be raised through deficit financing. Adding to this Rs. 800 crores by way of resources to be raised externally, the total or resources for the public sector amounts to Rs. 4400 crores. This still leaves a gap of Rs. 400 crores which has ultimately to come from additional domestic resources and the only possible source that can be drawn upon for meeting this gap is taxation.

¹ Planning Commission, Government of India, Second Five Year Plan, p. 27.

Resources have to be saved for implementing the program of investment and taxation is the most effective and equitable way of securing the required savings. The proportion of tax revenue to national income is low in India--only about 7 percent as against 11 percent in Malaya and 15 percent in Burma. Additional taxation will raise this proportion only marginally. It is, however, recognized that taxation has its limits and has to be supplemented by other devices such as fiscal monopolies in selected lines and economies in expenditure.

It will also be seen that the outside limit to deficit financing has been placed at Rs. 1200 crores or 25 percent of the total development expenditure proposed for the public sector. In assessing the likely reactions of the proposed deficit financing, it may be noted that against the proposed deficit must be set off the drawing down of Rs. 200 crores of sterling balances. The remaining deficit of Rs. 1000 crores represents the net addition to currency in response to the Government's budgetary operations. A developing economy requires an increasing money supply and up to a point, deficit financing is safe and even necessary. But beyond a point, deficit financing is inflationary. Reliance on this mode of raising resources to the extent of Rs. 1000 crores, therefore, involves considerable risk. This has to be undertaken in the interest of development but at the same time, it has been emphasized in the Plan that any adverse repercussions of deficit financing will have to be dealt with in all possible ways--through the adoption of the necessary safeguards, correctives, and controls as the situation may require.

It has been stated already that the necessity of importing the required machinery and equipment from abroad in the early stages of industrialization presents the special problem of foreign exchange resources. While it is difficult to forecast foreign exchange requirements over a period of five years, the estimate of Rs. 800 crores has been framed on certain assumptions. In the first place, it has been assumed that the terms of trade during the Plan period will remain on an average the same as in 1955-56. Secondly, it has been assumed that inflationary pressures would be held firmly under control. If both these assumptions hold true, the aggregate balance of payments deficit on current account may not exceed Rs. 1100 crores. A part of the deficit will be covered by drawing down the sterling balances by about Rs. 200 crores. The gap of Rs. 900 crores of which Rs. 100 has been assigned for investment in the private sector will be covered by loans in foreign markets, by borrowing from the World Bank, by loans and grants from other international institutions, through private foreign investment, and finally through loans and grants from friendly foreign governments.

Investment in the Private Sector. The investment requirements of the private sector are estimated at Rs. 2400 crores. Although it is difficult to indicate the sources of savings for this sector as only a small proportion of the total savings utilized in this sector passes through institutional agencies, it is possible to frame a broad estimate of resources only for the organized sector of the private industry. For the Second Plan period, the total investment on industrial programs in the pri-

vate sector has been estimated at Rs. 620 crores as follows:

Table 4. Partial Estimates of Sources of Financing for Private Investments.¹

| | Crores of Rupees | |
|--|------------------|-----------|
| | 1951-56 | 1956-61 |
| 1. Loans from Industrial Finance Co-operation and State Finance Co-operations and Industrial Credit and Investment Corporation | 18 | 40 |
| 2. Direct and indirect loans from governments, central and state participation | 26 | 20 |
| 3. Foreign capital, including supplies credit | 42 | 100 |
| 4. New Issues | 40 | 80 |
| 5. Internal resources (for new investment and replacements) | 150 | 300 |
| 6. Other sources such as advances from managing agents, EPT refunds, etc. | <u>64</u> | <u>80</u> |
| | 340 | 620 |

National Income

The fulfillment of the targets of production and development will naturally lead to an increase in national income which is the main objective of the Plan. It has been estimated that national income will increase by 25 percent and the per capita income by about 18 percent during the Second Plan period. The assumptions underlying these estimates are indicated below:

¹Reserve Bank of India, Report on Currency and Finance, 1955-56, p. 91.

Table 5. Net National Product Realized 1950-51, 1955-56 and Estimates for 1960-61.¹

| | : | : | : | : | Percent |
|--|-----------|---------|----------|----------|-----------------|
| | : | : | : | : | increase during |
| | :1950-51: | 1955-56 | :1960-61 | :1951-56 | 1956-61 |
| 1. Total National Product (National Income) | 9110 | 10,800 | 13,480 | 18 | 25 |
| 2. Per Capita Income (Rs.) | 254 | 281 | 330 | 11 | 18 |
| <u>Investment, Savings and Consumption</u> | | | | | |
| 1. Net Investment | 448 | 790 | 1,440 | | |
| 2. Net Inflow of Foreign Resources | -7 | 34 | 130 | | |
| 3. Net Domestic Savings | 445 | 756 | 1,310 | | |
| 4. Consumption Expenditure (National income less net domestic savings) | 8665 | 10,044 | 12,170 | | |
| 5. Investment as percent of national income | 4.94 | 7.31 | 10.69 | | |
| 6. Domestic savings as percent of national income | 4.98 | 7.00 | 9.72 | | |

The projected total investment of Rs. 6200 crores during the Second Plan period envisages broadly an increase in the rate of domestic saving from 7 percent in 1955-56 to about 10 percent of national income in 1960-61. If external resources of the order of Rs. 1100 crores are available as expected, total consumption expenditure may increase by some 21 percent as against the estimated increase in national income by 25 percent.

¹ Reserve Bank of India, Report on Currency and Finance, p. 87.

PRICE POLICY IN PLANNING

The preceding sections have pointed out the importance of price in an economic system as a choice indicator and a guidance mechanism. It was further developed that India has adopted a mixed economy consisting of a sector of private investment co-ordinated with a public sector within the framework of National Planning to achieve economic development. The behavior of prices will have an important effect on the end result of this experiment in democratic planning. More aptly stated, the National Planning effort must include a price policy which will make the price mechanism an active force working toward the objectives of the Plan instead of being a disruptive mechanism.

Two important aspects of price must be considered within price policy. The first is the stability of the general level of all prices. The second is the pattern of price relationships between sectors and between industries, including factor prices.

Price Stability

Price stability depends on the relationship between aggregate money demand and aggregate supply of goods within the economy. The relationship can be illustrated as $\frac{MV}{T} = P$ in which MV is the aggregate money demand or purchasing power per unit of time; T represents the aggregate supply of goods and services, and P is the general price level. Therefore, an increase in MV, T remaining constant or increasing at a slower rate will result in upward

pressures on the price level. Conversely, a decrease in MV, T remaining constant or decreasing more slowly than purchasing power, would result in a price depressing situation. A change in MV accompanied by an equal change in T would result in stable price levels.

Economic development necessarily means expanding the aggregate supply of goods forthcoming over time within the economy. Therefore, development includes forces acting in one way or another on the price level. At the very outset, any treatment of price and output recession will be eliminated from further consideration due to the fact that this situation is inconsistent with the goals of development, and therefore, should not be allowed to occur. Within the framework of expanding economic activity, three basic price policies can be delineated, namely, (1) increased output accompanied by generally falling prices, (2) increased output with rising prices and increased output accompanied by a stable price level.

Increased Output with Gradually Falling Prices. As development takes place, if the money supply is held constant, then general price levels will have to fall gradually as output is increased. Theoretically, firms will be able to expand in the face of falling prices due to decreased costs. Falling prices will at the same time increase real income which will provide for the distribution of the additional output.

In reality this alternative is not feasible and for practical purposes can be discarded from further consideration. In order to

shift resources into the development programs without resorting to the totalitarian state procedure of completely centralizing the allocating procedure and using direct allocation of physical goods and assignment of labor, purchasing power will be expanded through deficit financing. Consequently, in the process of the investment program as outlined in the preceding section, purchasing power will automatically be expanded.

Continuously falling prices have a depressing effect on the economy. Investment necessitates fixed expenditures in anticipation of future income over time. Consequently, continuously falling prices would give rise to a situation which would discourage private investment. An important goal of the National Planning Program is to encourage private investment to play as important a role as possible in the development effort.

On the consumer side of the market, increasing incomes despite increasing prices would most likely be more acceptable than fixed incomes and falling prices. Increased monetary income makes a far greater impression on the individual, even though prices increase somewhat at the same time, than does increased real income resulting from falling prices. Hence, the consumers probably would feel that their interests were being protected in the development program under some other alternative than fixed purchasing power and falling prices.

Increased Output with Stable Prices. If the money supply is allowed to increase at the rate at which output is being increased, then it would be feasible to realize an expanding economy under

stable prices. This result would be an optimum climate in which to further development. With a stable price situation, price risk would be at a minimum and private investors could estimate anticipated future income from new investments without the uncertainty of price risks. This should create a climate favorable to private capital expansion and economic development. Incomes would be rising as wage rates increased slowly and the increased monetary incomes would enable the consumers to draw from the market the increased flow of goods forthcoming as a result of economic progress. In this case monetary and real incomes would be increasing thus bringing home to the individuals that they had a stake in the program of development.

With proper direction given to private investment and adequate support from the public sector of investment, the private sector could take on the responsibility of a significant proportion of the task of investment for development. Therefore, stability of general price levels would be an optimum policy to adopt within the framework of the national planning program.

Increased Output with Rising Prices. Although the alternative of development under stable price levels may be an optimum, the realization of this policy may be somewhat difficult to implement. A third alternative is to have purchasing power increasing at a faster rate than output with a corresponding rise in price levels over time. To the extent that increased consumption is allowed, incomes will be allowed to increase faster than the price level; this, in turn, will result in increased real in-

comes arising from the gains realized through the development program. In this case the rate of increase in the price level should not exceed, to any great extent, the rate of increase in real income over time.

The policy of a general upward trend in prices is perfectly acceptable as a policy and even is held to be the only feasible policy by some economists. Generally rising prices are conducive to investment and thus would tend to stimulate private investment over time.

A word of caution must be interjected in relation to this policy. As long as the price level rises at or near the rate of the increase in real income in the economy, little or no inflation is occurring and no real danger exists. However, if the investment phase of the development program is expanded beyond the ability of the economy to absorb the additional investment, the outcome may be inflationary. This is almost inevitable during early stages of the investment program where deficit financing brings about almost an immediate expansion in incomes but a time lag exists while the actual construction phase of the investment is completed and additional output can be realized. This increase in purchasing power thus gives rise to upward pressure on prices at a time when additional goods are not forthcoming to offset the increase in purchasing power, thus resulting in inflation. If the inflationary increases can be held down to a minimum, no serious consequences need result. However, in following a policy which is inflationary in its impact on the economy, caution

must be used to make certain that the "trickle" of inflation does not become a flood to the final destruction of the entire program. Once run-away inflation is encountered, severe reaction can be expected with sudden and vast changes in the social structure and institutional framework. The outcome could be a complete loss of any gains made in democratic planning and a complete loss of opportunity to carry democratic planning to successful completion.

In summary, a policy of stable prices is most desirable as a complement to the development program. However, in case that stable prices cannot be maintained it is hoped that price rises resulting from the nature of the financing techniques used in the investment program can be held to a gradual increase at about the rate at which real income could be expected to increase during latter stages of the development program. Under a policy of a "small" amount of inflation, extreme caution must be maintained that the amount of inflation does not get out of hand thus in the end result destroying the entire program.

Price Relationships

Within the broad framework of stable prices, it is necessary to maintain appropriate price relationship between agricultural and industrial commodities, between different industries, and also between competing crops within the agriculture sector. Rational allocation of resources between the agricultural and industrial sectors requires that the terms of trade should not shift too sharply against one or the other. If prices in the agricultural

sector are allowed to fall to unremunerative levels, there would be reduction in the purchasing power in a sector which contributes 50 percent of the national income. This may cause a slump in the market for manufactured goods which in turn may bring in its wake unemployment, thus starting a vicious circle of recession which may upset the Plan. On the other hand, a sharp rise in agricultural prices would have its inevitable effect on the costs of the finished products and retard the progress of industrialization.

In India there are some industries like the jute industry, sugar industry and the textile industry in which prices of raw materials account for the major portion of the costs of the finished products. For balanced development of the two sectors of the economy, it is essential that there should be an appropriate relationship between the prices of jute and jute goods, sugar cane and sugar, and cotton and cloth. Although minimum price has been fixed for sugar cane and floors and ceilings are in operation for cotton, sharp fluctuations in the prices of sugar or cloth, if allowed to persist, may cause a serious deviation in the pattern of production and consumption.

In the public sector, particularly in heavy industries like the coal mining industry and the iron and steel industry, the Government fixes the factor prices as well as the prices of the finished products, but due account needs to be taken of the effect of such price fixation on producers as well as consumers. For instance, in the coal mining industry, labor costs account

for about 70 percent of the total cost of production of the industry. There is a close link between wage and price in this industry, therefore, utmost caution is needed in determining the wage-price structure. An increase in wages as a concession to the demand of the mine workers would automatically raise the cost of production and the sale price with its immediate repercussion on the consumer's cost of living; on the other hand, if the floor price for coal is treated as a ceiling price in response to the demand of some consumers, this may lead to cut throat competition among some collieries and the closure of some mines. The fixation of labor costs has also to be viewed in the context of the need for optimum distribution of labor services between different industries. In the iron and steel industry, Government fixes retention price for iron and steel together with a selling price for the consumer which is set at a higher level to provide an equalization fund out of which payments are made for subsidizing imports of steel and for financing the renovation and modernization of the steel industry. An increase in the retention price to give additional incentive to production is fraught with the possibility of a reduction in the equalization fund or an increase in the consumer's cost of living. Price fixation is thus a difficult and complicated task and very often involves a balancing of the conflicting interests of producers and consumers.

In stepping up the investment programs of particular industries, it seems necessary to take into account, among other factors, the income elasticity of the consumers for the products

of these particular industries. If the income elasticity is relatively high for industrial goods which have not received sufficient priority in the investment programs, the result may be inflationary pressure on the prices of these goods. On the other hand, there will be an inefficient allocation of resources for those industries which are associated with relatively low income elasticity but which may have been included among the core projects.

An appropriate relation between prices of competing agricultural commodities is also essential for realizing the planned targets of production of the different crops. It should be remembered that resource substitution is relatively easier within agriculture than between agriculture and industry and a distortion in the relative price movements of agricultural commodities may lead to an undesirable shift in acreage from one crop to another. For instance, jute and paddy, cotton and sorghum, and maize and sugar cane are competing crops in India. Within this competitive range, there will be a natural inducement to shift the acreage from one crop to another if the price of the one becomes definitely more attractive than that of the other. Such a shift in acreage may be in violation of the planned pattern of development, thus seriously upsetting the realization of the targets set out in the Plan.

In summary, it may be said that a stable or gradually rising price level is as important as the maintenance of an appropriate balance between the prices in the different sectors and also be-

tween competing crops or commodities within the same sector. In the case of India it is necessary to emphasize the close relationship between the stability of the general price level and the stability of agricultural prices. In highly industrialized countries, the general price level may not be affected significantly by the behavior of agricultural prices, but in India, where agriculture is the prime industry, agricultural prices form the pivot around which the entire price structure moves. Prices of industrial products can be stabilized only if the prices of raw materials and of foodstuffs are stable.

The broad objectives of price policy for the Five Year Plan may now be summarized as follows:

1. To prevent sharp fluctuations in the general level of prices and to maintain stable, or in the alternative, gradually rising prices which will be conducive to investment and enterprise.
2. To stabilize the prices of agricultural commodities within certain reasonable limits and inter alia.
 - (a) To maintain a reasonable relationship between the prices of agricultural commodities and those of manufactured articles with a view of ensuring that the terms of trade between these two important sectors of the economy do not change too sharply against one or the other;
 - (b) To maintain price relationships within the sphere so as to maintain an appropriate relationship between

agricultural sector consistent with the prices of competing crops necessary for fulfilling the targets of the Plan;

(c) To reduce seasonal fluctuations in agricultural prices to the minimum.

3. To stabilize the prices of manufactured articles within certain reasonable limits.

BEHAVIOR OF PRICES IN RECENT YEARS

In the preceding chapter, we have indicated the broad objectives of a price policy which is necessary for the successful implementation of the Five Year Plans. It will now be interesting to see how far the actual behavior of prices in recent years has fulfilled these objectives and to what extent the actual pattern of price movement has been conducive to the planned pattern of development. For this purpose, we shall first of all study, on the basis of index numbers of wholesale prices, the order of variations in the general price level during the last five years and also compare the variations in prices between agricultural and industrial commodities during this period. The following table sets out the basic data.

Table 6. Index Numbers of Wholesale Prices (Base: 1952-53 = 100).¹

| | 1953-54 | 1954-55 | 1955-56 | 1956-57 | 1957-58 |
|--------------------------|---------|---------|---------|---------|---------|
| All commodities | 104.5 | 97.4 | 92.5 | 105.3 | 108.4 |
| Food articles | 106.7 | 94.6 | 86.6 | 102.3 | 106.4 |
| Industrial raw materials | 109.7 | 101.9 | 99.0 | 116.0 | 116.5 |
| Manufactures | 98.9 | 100.6 | 99.7 | 106.3 | 108.1 |

It will be seen that prices declined from 1953-54 to 1955-56 and that there was a reversal of this tendency from 1955-56. It will also be seen that the movement of prices has been in the same direction for all the groups during this period. The order of variations has, however, differed from group to group and this will be evident from the following table computed from the above basic data:

Table 7. Fluctuations in Group Index Prices in Recent Years.²

| | Order of fall between 1952-53 and 1955-56 (Percent) | Order of rise between 1955-56 and 1957-58 (Percent) |
|--------------------------|--|--|
| All commodities | -11.5 | 17.2 |
| Food articles | -18.8 | 22.9 |
| Industrial raw materials | - 9.7 | 17.7 |
| Manufactures | - 1.1 | 9.3 |

The above data indicate that price fluctuations in both directions were the highest for the "food articles" group and the

¹Computed from the Weekly Bulletins on Index Numbers of Wholesale Prices issued by the Office of the Economic Adviser to the Government of India.

²Ibid.

lowest for the "manufactures" group. Variations in prices of industrial raw materials were also significant, but they were of a considerably lower order than those displayed by the food articles group. It will also be seen that the "all commodities" index which reflects the general price level showed a significant upward and downward movement during this period and that within a brief span of five years there was almost a complete swing of the pendulum from one extreme to another. In other words, the first objective of price policy, i.e., "to prevent sharp fluctuations in the general level of prices" cannot be said to have been fulfilled.

It is now proposed to analyze annual variations in prices as between agricultural commodities and manufactured articles during the period under review. The relevant data are as follows:

Table 8. Variations in Prices of Agricultural Commodities and Manufactured Articles in Recent Years.¹

| : Agricultural Commodities : | | | Manufactured Articles | | |
|-------------------------------|-------|-------|---------------------------|------|------|
| : : Percent Variation : | | | : Percent Variation | | |
| : Price : from the Previous : | | | Price : from the Previous | | |
| : Index : | Year | | : Index : | Year | |
| 1952-53 | 100 | | 100 | | |
| 1953-54 | 107.4 | 7.4 | 98.9 | | -1.1 |
| 1954-55 | 96.3 | -10.3 | 100.6 | | 1.7 |
| 1955-56 | 89.5 | -7.1 | 99.7 | | -0.9 |
| 1956-57 | 105.5 | 17.3 | 106.3 | | 0.6 |
| 1957-58 | 108.8 | 3.1 | 108.1 | | 0.7 |

The above will show that while prices of manufactured articles as a whole have not shown wide variation in any year, the same

¹Ibid.

cannot be said to be true of agricultural commodities in general. In two out of five years, the fluctuations exceeded 10 percent of the preceding year's level and in one year, 1956-57, the price was about 18% higher than in the previous year. Thus while one objective of price policy, "to stabilize the prices of manufactured articles within reasonable limits," appears to have been fulfilled, largely due to price control in the public sector, the other and the more pressing objective, i.e., to stabilize the prices of agricultural commodities, which are more liable to the vagaries of market forces has not met with success.

Agricultural commodities comprise mainly foodgrains and commercial crops. It may now be interesting to study the relative variations in the prices of foodgrains and commercial crops and see which of the two constituents has been mainly responsible for preventing the "prices of agricultural commodities to be stabilized within reasonable limits." The fluctuations in annual prices of some important foodgrains and commercial crops during the years 1955 to 1959 are given in Table 9.

Table 9. Annual Fluctuations in Prices of Foodgrains and Commercial Crops (Percentages Variations over Preceding Years).¹

| | : March : 1955 | : March : 1956 | : March : 1957 | : March : 1958 | : March : 1959 |
|------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| Foodgrains | | | | | |
| Rice | -16 | ✓20 | ✓13 | ✓5 | -7 |
| Wheat | -18 | ✓19 | ✓12 | -11 | ✓12 |
| Jowar | -44 | ✓42 | ✓17 | -21 | ✓14 |
| Commercial Crops | | | | | |
| Cotton | -15 | ✓16 | ✓6 | -9 | --- |
| Jute | ✓47 | -14 | ✓9 | -10 | -6 |
| Groundnut | -42 | ✓59 | ✓10 | -8 | ✓17 |

¹Ibid.

It will be seen that while prices of both foodgrains and commercial crops have fluctuated during this period, the order of variations has not been uniform. For a precise idea of the normality or otherwise of the variations in the prices and for a comparative study of the intensity of fluctuations as between foodgrains and commercial crops, a frequency table has been constructed on the basis of the percentage variation for the five year period in respect of the commodities grouped under foodgrains and commercial crops. In Table 10, the number of observations as well as the percentage of such observations to the total for a particular class interval has been indicated.

Table 10. Variations in Prices over the Preceding Year for Foodgrains and Commercial Crops.

| Percentage Variation in Prices over the Preceding Year | Foodgrains | | Commercial Crops | |
|--|------------------------|---------------------------------------|------------------------|---------------------------------------|
| | No. of Observations | Percent to Total Ob- servations | No. of Observations | Percent to Total Ob- servations |
| Above 20 | 1 | 6.7 | 2 | 13.3 |
| 16 to 20 | 3 | 20.1 | 2 | 13.3 |
| 11 to 15 | 4 | 26.7 | - | -- |
| 6 to 10 | - | -- | 3 | 20.0 |
| 0 to 5 | 1 | 6.7 | 1 | 6.7 |
| 0 to -5 | - | -- | - | -- |
| -6 to -10 | 1 | 6.7 | 4 | 26.7 |
| -11 to -15 | 1 | 6.7 | 2 | 13.3 |
| -16 to -20 | 2 | 13.3 | - | -- |
| Below -20 | 2 | 13.3 | 1 | 6.7 |
| TOTAL | 15 | 100.0 | 15 | 100.0 |
| Assumed | | | | |
| Normal 0 to ± 10 | 2 | 13.3 | 8 | 53.2 |
| Above Normal, above ± 10 | 13 | 86.8 | 7 | 46.8 |

It is apparent that both foodgrains and commercial crops showed about as many variations on the positive side as on the negative side. But if fluctuations up to ± 10 annually are assumed to be normal, then while about 47 percent or less than half the observations of commercial crops showed annual fluctuations greater than this level, in the case of foodgrains, 87 percent of the observations were above normal and only 13 percent of the observations showed normal fluctuations. From this it is clear that the fluctuations in the prices of agricultural commodities were mainly due to rather abnormal variations in the prices of foodgrains. This also shows that the inter-relationship between the prices of foodgrains and competing commercial crops has been disturbed to the disadvantage of the producers of foodgrains. This also explains why in the case of foodgrains, sometimes even direct physical controls were considered necessary, while in one case of commercial crops, stability in prices has been sought through such indirect measures as adjustments in export/import quotas and duties.

The commodity terms of trade will give an indication of the relative shifts in the position of these two sectors of the economy. In computing the commodity terms of trade the index numbers of wholesale prices for the "manufactures" was taken to be representative of the movement in the industrial sector, while the agricultural sector was described by index numbers of wholesale prices for foodgrains, food articles, and agricultural commodities as a whole.

The relevant data are as follows:

Table 11. Ratio of Prices of Groups of Agricultural Commodities to Prices of Manufacturers.¹

| | Ratio of Index of Prices | | |
|---------|--------------------------|---------------|----------------|
| | Foodgrains | Food Articles | Agricultural |
| | to | to | Commodities to |
| | Manufacturers | Manufacturers | Manufacturers |
| 1952-53 | 100.0 | 100.0 | 100.0 |
| 1953-54 | 99.8 | 109.8 | 108.6 |
| 1954-55 | 75.3 | 94.0 | 95.7 |
| 1955-56 | 73.7 | 86.9 | 89.8 |
| 1956-57 | 87.8 | 96.2 | 99.2 |
| 1957-58 | 90.5 | 98.4 | 100.6 |

The above shows that by and large the terms of trade have been adverse to the agricultural sector. One significant feature which deserves special mention in this connection is that between 1953 and 1955, while prices of agricultural commodities showed a sharp fall, there was hardly any decline in the prices of manufactures. In the subsequent "recovery" prices of agricultural commodities rose but those of manufactures also showed an increase. It was this tendency for the prices of manufactures to share the rise but not the fall in prices with agricultural commodities that has been responsible for the terms of trade to move against agricultural sector in recent years. Thus we are still away from our objective "to maintain a reasonable relationship between the prices of agricultural commodities and those of manufactured articles."

¹Ibid.

Seasonal variations in prices are features common to almost all agricultural commodities. The variations differ from commodity to commodity and from one region to another. Broadly, however, if a comparison is made between seasonal variation during the recent five years, 1953 to 1958, with those for the preceding five years, 1944 to 1952, it will be seen that the amplitude of variations has widened in the more recent period. This will be clear from the following:

Table 12. Seasonal Variations in Prices for Selected Commodities.¹

| | Peak | | Trough | |
|-----------|---------|---------|---------|---------|
| | 1944-52 | 1953-58 | 1944-52 | 1953-58 |
| Wheat | 28.1 | 47.0 | -16.6 | -46.0 |
| Rice | 32.8 | 38.8 | -31.6 | -32.3 |
| Groundnut | 16.2 | 38.3 | -28.7 | -77.3 |
| Cotton | 9.6 | 9.7 | - 9.0 | -14.3 |

It will be seen, except for cotton, the seasonal swings are quite wide for wheat, rice and groundnuts and that the variations have been wider in the recent period (1953-58). We have, therefore, still to achieve the objective of "reducing seasonal variations in the prices of agricultural commodities to the minimum."

CONCLUSIONS AND RECOMMENDATIONS

The Second Five Year Plan will come to a close at the end of 1960-61 and work is already in progress in India in connection

¹Computed from the data on Weekly Wholesale Prices collected by the Director of Economics and Statistics, Ministry of Food and Agriculture, Government of India.

with the formulation of the Third Five Year Plan. Each Plan is a further step forward in the process of development and at the same time provides a basis for estimating the tasks that lie ahead. In a country which has embarked on a program of accelerated development, achievement in one Plan is a call for further and more concerted effort in the next.

The broad objectives of the Third Five Year Plan have already been announced in the Indian Parliament by the President of India. As in the Second, so also in the Third, the aim will be to bring about a further increase in national income; to promote more rapid industrialization; to open out further avenues of gainful employment; and to work towards a reduction in inequality of income and wealth.

The objectives of price policy stressed in the Second Plan will naturally be re-emphasized in the third. If a climate of economic stability is desired, it is necessary to combat both inflationary and deflationary tendencies; the price level must be fair both to the producer and the consumer; there must be a balanced and simultaneous development of both the public and private sectors and a rational allocation of resources between the two sectors through appropriate price mechanism.

Economic indications in the last few years have shown that inflationary pressure was strong during the Second Five Year Plan period; that the price level was far from stable, that the inter-relationship of prices between the agricultural and industrial sectors was seriously disturbed and that the relative structure

was hardly conducive to efficient allocation of resources in the private sector.

The need is, therefore, not merely to define an appropriate price policy but also to take effective measures to implement that policy. The objectives of the price policy have not merely to be emphasized--the success of the Plan demands that there should be speedy fulfillment of these objectives. More than ever, there is need to keep a close and constant watch on the relative movement of the prices of the factors of production as well as those of the finished products. Whenever the inter-relationships of prices tend to deviate beyond a level considered conducive to the rational allocation of resources or to the achievement of the defined aims of the Plan, corrective actions, monetary, fiscal and others have to be taken promptly and effectively.

Monetary and Fiscal Policy

The most important corrective actions of an over-all character bearing on the level of prices are monetary and fiscal policies. The monetary policy is implemented by the Reserve Bank of India through open market operations, changes in the bank rate, and variation in the reserve ratio. Fiscal control is exercised through variation in the size and pattern of expenditure and revenue. Experience has shown that monetary policy alone is not an adequate defense against severe economic depression and decline in prices. As Keynes himself points out, an increase in the quantity of money will not lower the rate of interest if liquidity preference

is increasing more than the quantity of money. It is true that a fall in the rate of interest, other things being equal, will increase investment and employment and in that process induce a recovery in prices, but this will not be the case if marginal efficiency of capital is falling more rapidly than the rate of interest. In a severe depression, when the preference for liquidity is high and the expectations of entrepreneurs for profitable investments are low, monetary policy may be helpless in breaking the economic deadlock and in inducing a recovery in prices and investment. In a period of inflation, however, the tools at the disposal of the Reserve Bank are more effective. Through sales in the open market, increased bank discount rates and more particularly through an increase in reserve ratio requirements, it is possible to curb the money supply and credit.

Reliance on monetary policy alone in a period of inflation is, however, risky since such "strong weapons" as are used in the Reserve Bank may not always be appropriate to the delicate task of controlling the flow of income in the economy, particularly when the aim is to reconcile stability with accelerated economic growth. Opinion is now unanimous that monetary policy has to be coordinated with fiscal policy. Fiscal control operates on the expenditure as well as revenue side of the budget. In a period of falling prices, the expenditure side of fiscal policy can prove to be helpful. There, the objectives of rapid economic growth and stable conditions are in harmony with each other. In a period of inflationary pressure, fiscal control may

operate through curtailment of expenditure and a consequent reduction in Governments contribution to total spending. But as this may involve a cut-back in investment relative to targets of the Plan, this may not be acceptable to the Government and the people. Greater emphasis has, therefore, to be laid on fiscal policy on the revenue side and on fiscal control which operates through an alteration in the source of finance. Of all types of financing development expenditure, borrowing from the Reserve Bank and "the creating of new money," known as deficit financing, is the most inflation-biased. On the other hand taxation is the most anti-inflationary method, there is, therefore, always a preference for a shift in the source of financing from deficit financing to taxation whenever there is a build up of inflationary pressure in the economy. Taxation is no doubt the most effective and equitable way of securing the required saving of domestic resources, but it has also its limits. When taxation is pushed to such an extent that it falls on those whose "propensity to consume is very near unity," the shift from deficit financing to taxation will defeat the very object of planning by reducing the living standard of the people. When this situation exists, it is indicative that planned investment targets have been set too high.

It is, therefore, generally agreed that deficit financing up to a point is not only permissible but even desirable in a developing economy. The magnitude of deficit finance which is considered to be safe for a particular country at a particular time, however, depends on several factors. As the United Nations

study on deficit financing points out, these factors include "the extent of unutilized or under-utilized resources available, the time lag between investment and the flow of final products, the availability of foreign exchange resources which can be used as a cushioning factor, the habit of cash hoarding, the general state of expectation of the people, the effectiveness of the various controls, the response of the people to the appeal for public support, etc."¹ The Taxation Enquiry Commission of India pointed out that there was no formula by which the amount of deficit finance could be determined. This ultimately was a matter of judgment. In the light of present conditions and immediate trends in the economy, a moderate measure of deficit financing would not inflict any injury to the economy.

Deficit financing undertaken during the second Plan period was not, however, of a moderate order. It covered as much as 25 percent of the total development expenditure in the public sector, and impressed a strain on the economy which had made price rise inevitable. Corrective measures could only modify the impact of the rise in prices but could not completely alleviate it. Even monetary and credit policy had assumed a subsidiary role to the primary influence of this aspect of fiscal policy. Indeed monetary and credit policy had, to a considerable extent, to be adopted to the economic climate created by the fiscal policy.

¹Economic Bulletin for Asia and the Far East, United Nations, November, 1954.

Resort to deficit financing, therefore, always involves an element of risk and it is necessary to monitor its effects carefully and adjust subsequent programs in the light of these effects. The road to inflation is easy enough, but it may open flood gates which it would later be impossible to close.

Appropriate monetary and fiscal policies will set the general climate for economic stability; however, these must be supplemented by specific measures directed towards the regulation of prices, both in the agricultural and industrial sectors.

Buffer Stock Operations

In the case of agricultural commodities, one of the most important methods of implementing price policy is to resort to what is known as "buffer stock operations." Whenever prices tend to fall, the buffer stock administration will enter the market as a buyer; its purchases will reduce the pressure of supply and strengthen the prices. On the other hand, when prices tend to rise, this organization should sell from its stock. It may be necessary for this organization to fix limits of prices at which it will buy or sell. If it starts operating from a position of strength with sufficient stocks at its disposal and sufficient funds to invest, it will be able to control the market forces effectively. It will then be able to depress prices when the market is rising and support prices when the market is falling. This would go a long way to protect both the producer and the consumer against violent fluctuations in prices.

In a planned economy, the operation of buffer stocks assumes special importance. If the purchasing power in the agricultural sector is allowed to go down, it is sure to bring about a slump in the demand for manufactured goods and in its wake start a vicious circle of recession which may upset the Plan completely.

Manufactured Articles

To begin with, prices of manufactured goods fluctuate less than for agricultural goods, furthermore, programs aimed at stabilizing agricultural as well as general price levels will add to the stability. Index numbers of costs and prices should be computed for very large or semi-monopolistic industries both in the public and private sectors. These index numbers should be kept under constant review not only from the standpoint of price policy but also in order to determine the need for re-orienting their activities. It may be mentioned here that in the U.S.S.R. such indices are used for fixing targets for the reduction of costs of individual enterprises.

Deployment of Resources

Another suggestion which has been put forward is that all the schemes included in the Five Year Plan may be classified as (a) production schemes and (b) schemes of economic overheads. Production schemes may be again divided into "early maturing" and "late maturing" schemes. The object should be to step up investment programs on early production schemes in periods of inflation

and on economic and social overheads in periods of deflation. Further every scheme may be sub-divided into two parts, one a "rigid" part and the other a "flexible" part. The former must be continued under all circumstances while the latter may be suitably adjusted according to the situation. This would ensure strategic deployment of resources which is no less necessary than mobilization of resources. It may also be useful in this connection to study the time lag between investment programs and the effect produced by them on prices and wages.

It is expected that if these various measures are taken it will not be necessary to have recourse to direct physical controls to any great extent. Direct physical controls are not only irksome but also have very harmful effects in the long run and should not, therefore, be resorted to except in great emergency and even if used should not be continued beyond the absolutely minimum period necessary.

There seems to be a feeling in some quarters that inflation will continue to be the main problem during the Third Five Year Plan period. Although there was a strong inflationary pressure during the Second Plan period and there is a possibility of its continuance during the Third Plan period, there is also the danger that additional supply of goods may outstrip additional purchasing power in some sections at least in the short run. Our objective should, of course, be to avoid both inflation and deflation, but if the choice lies between a mild inflation and recession, it is always preferable to avoid the latter rather than the former, for

a mild inflation provides a much better climate for investment and economic development.

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A STUDY OF PRICE POLICY FOR SUCCESSFUL
NATIONAL PLANNING IN INDIA

by

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India attained political independence only about a decade ago. Since then, the attention of the people and the Government has been focused on winning economic independence. The object is to promote the welfare of the people by eliminating poverty, ignorance, and disease and by opening out equal opportunities to all for a richer and more varied way of life.

Opinion was unanimous, that in order to achieve these basic ideals in India, the state should take up the responsibility for formulating a series of plans for the development of the economic resources of the country. National planning was deemed necessary because it was believed that individual private enterprise was not likely to achieve development on a scale and at a rate that was needed. Besides there were so many unknown risks and un-chartered areas to cover that private risk bearers were not expected to plan their operations in a manner that would be consistent with the basic development of the country.

The First Five Year Plan was drawn up in 1950-51 and the Second in 1955-56. The Second Plan was intended to carry forward the process of economic development initiated in the First and to prepare the way for more accelerated development in succeeding periods. The principal objectives of the Second Plan were to bring about a sizeable increase in national income, to promote rapid industrialization, to open out opportunities for more gainful employment and to work for a reduction in inequalities of income and wealth.

The success of the Plan depends on the quantity of resources that can be mobilized and the efficiency with which these resources

can be directed towards priority uses. In India, the need is urgent for increased flow of resources for investment on development programs. But resources are scarce relative to ends, and the problem is the same as in any economy, namely, how best to allocate the limited resources between alternative ends. It is here that the price system comes into play because price is the common denominator of different ends and it is through prices that it is possible to record the pulls of the different ends which compete for services of the available resources.

In the modern world, no economic system relies on unregulated price mechanism for directing resources among uses. For one thing, competition is nowhere near perfect and all economic life is a blend of competition and monopoly elements. Even the free enterprise economy of the capitalistic system is a "mixed economy" in which state control is intermingled with market forces in organizing production and consumption.

India has also a mixed economy with a public sector comprising mainly of heavy industries, transport, and communications; a semi-private sector comprising light industries and some basic industries; and a purely private sector comprised mainly of agriculture. Within the framework of the mixed economy, the Government uses the price mechanism as a guiding force in directing allocation of resources towards the planned goals of development. When the need arises, regulation of market forces is considered necessary rather than leaving prices to be determined by the vagaries of an uncontrolled market. Thus the price system in India is a combination of free and administered prices, with price

administration being employed when deemed necessary to realize the defined ends of the Plan. Price administration may range from direct fixation of prices to indirect regulation of market forces through monetary and fiscal policy, and adjustments in export and import quotas and duties.

The need for a well-thought out and appropriate price policy assumes special importance in the type of mixed economy which India has chosen. In order that development, particularly in the private sector, may conform to the planned pattern, a good deal of direction to the economy must be given through prices. The broad objectives of price policy should be to prevent sharp fluctuations in the general level of prices and to maintain an economic climate suitable for investment and enterprise; to stabilize the prices of agricultural commodities within reasonable limits; to maintain an appropriate relationship between prices of agricultural and industrial commodities, and to protect the interests of both producers and consumers.

The actual behavior of prices in recent years has shown that the objectives of price policy are yet to be fulfilled. During the current Plan period, prices have shown wide fluctuations in both directions and the normal inter-relationship of prices between agriculture and industry has been disturbed to the detriment of the agricultural sector. There is, therefore, immediate need to take appropriate measures for implementing the price policy. A suitable monetary and fiscal policy should set the general climate for a stable economy. That aspect of fiscal

policy which has the most decisive impact on the price level is deficit financing. Experience has shown that deficit financing undertaken in the Second Plan period has caused an inflationary pressure on prices. Therefore, utmost caution is needed in fixing the limit of deficit financing. The optimum would be development under a stable price. However, if a choice is to be made between mild inflation and recession, the preference should be for the former rather than the latter. It must, however, be remembered that the road to inflation is easy. But it may open flood gates which may be difficult to close later.

Monetary and fiscal policy should be supplemented by special measures designed to exercise a regulatory influence on prices. An effective method of stabilizing the prices of agricultural commodities within reasonable limits and to prevent a distortion in the normal price structure would be to undertake buffer stock operations. The buffer stock administration should step into the market as a buyer when prices are low and release stocks out of its purchase for sale when market is rising. In this way, it can prevent violent fluctuations in prices and protect the interests of both the producers and consumers. In this way, it can help in maintaining an appropriate structure of relative prices which is essential for rational allocation of resources and the achievement of the desired ends of the Plan.